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SUBJECT: The Japan Economic Scope - February 2, 2007

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[1](#)3. (U) High Pathology Avian Influenza in Japan  
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Over the past month and a half Japan has undergone a series of four outbreaks of High Pathology H5N1 Avian Influenza. Three cases have been in Miyazaki Prefecture with one in Okayama Prefecture. The source is currently unknown but suspected to be commingling with wild birds. These outbreaks have resulted in the culling of over 170,000 birds. The most recent outbreak in Miyazaki is especially troubling because within the 10km quarantine zone there are currently 3.5 million broiler chickens, one of the largest chicken production areas in Japan.

[1](#)4. (U) Abe Urges Early Listing of Japan Post Corporation Stock  
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On January 26, the Postal Privatization Promotion Headquarters (chaired by Prime Minister Abe) instructed Japan Post Corporation to discuss concrete measures for the early listing of the two postal financial institutions and to start preparations for the early listing of Japan Post Corporation's own shares. Prime

Minister Abe repeated the statement in his policy speech that afternoon saying that it is important to implement privatization in October as scheduled. Abe told Headquarter members that after the privatization each postal entity must be quickly integrated into the private economy. The Prime Minister requested that each responsible Minister, i.e. Minister of Internal Affairs and Communications, Minister of Land, Infrastructure and Transport and Minister of Finance, make proactive efforts to accelerate privatization.

15. (U) USG Urges Postal Privatization Committee to Get Serious About Level Playing Field  
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On January 31, the USG submitted its comments to the Postal Service Privatization Committee (PSPC) on their "Findings Regarding the Investigation and Deliberation Over New Business Operations by the Postal Savings Bank and Postal Insurance corporation," The USG welcomed the PSPC's statement that the new Japan Post entities should be fully integrated into Japan's financial system on an equal basis with private financial institutions. At the same time, however, the USG indicated disappointment and concern that the Findings do not clearly mandate equivalent conditions of competition and urged the PSPC to include the requirement of truly equivalent conditions of competition. The USG urged that, after privatization, necessary measures should be implemented to eliminate the perception of a government guarantee and that rigorous inspection and supervision of the postal financial institutions should be established in the same manner as for other private financial institutions. The USG's comments also asked the PSPC not to allow the new postal financial institutions to enter into new businesses before establishing equivalent conditions of competition. In addition, the Japan Association of Corporate Executives (Keizai Doyukai) also submitted comments on the Findings to the PSPC saying that

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the PSPC's views could lead to a setback of the postal privatization process. The association insisted that the restructuring of current business operations to improve their efficiency must be the priority.

16. (SBU) ANRE's Hosaka Discusses Russian, Chinese Energy Issues  
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Agency of Natural Resources and Energy (ANRE) Petroleum and Natural Gas Division Director Shin Hosaka accompanied ANRE Director General Harufumi Mochizuki on a visit to Moscow the week of January 22 to talk to Gazprom about Japanese companies aiding the construction of a gas infrastructure in Eastern Siberia. Japanese companies are uninterested, however, because of the difficulty of the projects. Hosaka expressed frustration over Gazprom's takeover of Sakhalin 2 and praised ExxonMobil's management of Sakhalin 1, although he complained that its gas likely would go to China. He lamented the lack of cooperation from China over the East China Sea oil and natural gas dispute and blamed the warming relations between the two countries, claiming it prevents Japan from pressing China too hard to resolve the issue. For a complete read-out of this meeting, please see Tokyo 00478.

17. (SBU) Machimura Lauds Japan's Strengths, Calls for Improved Diplomacy  
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Former Foreign Minister Nobutaka Machimura assured listeners during a presentation this week on "Japan's Assertive Diplomacy" that Japan will surely become a permanent member of the UN Security Council in the near future. Describing Japan as among the most popular countries at the UN, he highlighted Japan's activities in Africa, such as training sessions for technical engineers, as meaningful and beneficial in the long term. He noted that many foreign countries appreciate Japan's overseas development aid (ODA) despite media criticism and he declared his support for aiding developing countries--in particular, Eastern

Europe--through Japanese monetary and technological aid. As Deputy Chair of the LDP Special Committee to Enhance Foreign Policy Capability, Machimura and Chairman Yoshio Mori plan to advocate an increase in the number of Japanese Embassies in Africa and Eastern Europe. Machimura promised that Japan would halt ODA to China after the 2008 Olympics because Japan can no longer tolerate China's investment in Africa in exchange for Africa's natural resources. Machimura defended the cost of the relocation of United States Forces Japan (USFJ)--most of which will be paid by Japan--explaining that Japan was the beneficiary of the USFJ's presence. He also referred to Foreign Minister Taro Aso's "Arc of Freedom and Prosperity," calling on Japan to strengthen ties with friendly nations that share common views and interests--namely the United States, Australia, India, and countries in the EU and NATO.

#### 18. (U) JFTC Releases New Merger Guidelines

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The Japan Fair Trade Commission announced a new set of merger review guidelines on January 31. The new rules eliminate the market share criteria for such mergers, with assessments based solely on an industry's market concentration. The JFTC will use the Herfindahl-Hirschman Index, which takes the squares of companies' market shares and adds them together to show an industry's concentration as a single number. For industries with international competition, the merging companies' share of overseas markets will be taken into account. Firms in industries facing global competition -- such as the semiconductor, LCD and software businesses -- are expected to be evaluated in terms of their market share worldwide. Steelmakers and others competing primarily with Asian rivals will be assessed by their share of the regional market.

#### 19. (U) Read-outs on Cebu Summit Meeting Results

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Telegrams Tokyo 448 and 450 report on views of GOJ officials on the outcomes from the East Asian Summit and related meetings, notably the implications for various initiatives on regional economic architecture and the effort to improve ties with South Korea and China.

#### 10. (U) Consumer Finance Legislation Already Leading to Contraction, Retrenchment of Industry

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Consumer finance legislation intended to protect borrowers passed by the Diet just over a month ago has prompted branch closures and has increased loss reserves and job cuts.

Citigroup, one of the largest players in the industry, plans to close 270 consumer finance branches and has allocated an additional \$375 million to cover anticipated losses due to what

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will now be considered interest overcharging.

The new law, which will lower maximum interest rates on these loans from 29.2 percent to 20 percent in the next few years, is expected to significantly lower profitability.

Credia, based in Shizuoka Prefecture, is just one of many regional lenders affected. Its decision to shut all 178 branches of its branches, cut its work force 30 percent, and focus primarily on screening loan applicants online, is typical of the response we are seeing by these lenders.

#### 11. (U) Japan's Core Consumer Price Growth Decelerates to 0.1% in December

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Japan's nationwide core CPI, which excludes perishable food items, rose 0.1 percent in December from the year before, after having increased 0.2 percent in November, the Ministry of Internal Affairs and Communications (MIC) announced January 26. Also, overall CPI was up 0.3% in December, the same rate of increase as

in November. Please see attached for more details.

¶12. (U) Midterm Economic Policy Guidelines Expect Over 2% Real, 3.5% Nominal Growth  
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On January 25, the Cabinet formally approved new medium-term economic policy guidelines for the FY07-11 period, formulated by the Council on Economic and Fiscal Policy (CEFP). The new guidelines, entitled "The Future Course and Strategy for Japan's Economy," represents the first keynote of a pro-growth economic agenda by the Abe administration, and serves as the basic roadmap for the management of economic and fiscal policy over the next five years. The CEFP forecasts the achievement of ambitious economic growth of more than 2 percent in real and 3.5 percent in nominal terms, by relying primarily on a substantial improvement in total factor productivity (TFP) and accommodative monetary policy. Please see attached analysis and reference guide for more details.

¶13. (U) GOJ Seeks to Boost Tokyo's Status  
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The CEFP and the FSA both launched study groups this week to make recommendations on ways to develop Tokyo as an international financial center. The groups are also charged with exploring ways to improve supervisory measures for "complicated financial transactions" and harmonizing Japan's accounting rules, financial market taxation, and corporate governance measures with global practices. Earlier this month, Financial Services Minister Yuji Yamamoto declared the government's intention "to create a hub bustling with many overseas financial institutions by offering tax incentives and other preferential measures." The focus has since been broadened to include improving the competitiveness of all Japanese financial markets, perhaps to accommodate suggestions from Osaka-based lawmakers.

The CEFP group's recommendations will likely be included in June's annual "big boned" policy program.

¶14. (U) KIX Victimized by Stock Fraud?  
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The Asahi Shimbun Kansai version reported recently that Kansai International Airport Co., Ltd. (KIAC) discovered that its unlisted stock had been sold by 11 investment companies to individual investors at 10-20 times the issue price; triggering an investigation by the Osaka Prefectural Police. KIAC is not, nor will it be, listed in the foreseeable future, but KIAC was surprised by inquiries from individual investors since last fall regarding potential IPO dates and called in the police. The GOJ and Osaka Prefecture together hold 88 percent of KIAC shares, with the remainder issued to private companies and individual investors. According to a KIAC official, three private companies holding KIAC's stocks in Osaka and Kyoto sold brokers 700 shares for the investment firms in question, falsely claiming that KIAC would be listed in 2007. The amount of damage for the fraud is estimated at more than 100 million yen. Although KIAC's stocks can be traded, selling in the market is not authorized.

KIAC's CFO told ConGen that they were the victims in this case, and that they worried about negative spillovers affecting KIX business after opening its second runway in July.

¶15. (U) JAL and ANA Announce 2007 Business Plans  
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Japan's two largest airlines, Japan Airlines (JAL) and All Nippon Airways (ANA) announced their FY2007 operational plans on January 29 and January 25, respectively.

JAL will increase flights on four domestic routes and add one new route in/out of KIX/Kobe airports while suspending ten routes and

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decreasing flights on five routes. In the midst of restructuring, JAL has cancelled its least profitable routes to focus more on

profitable ones. JAL is expected to announce the lay-off of 3,000 employees in early February.

ANA will increase flights in/out of KIX/Kobe airports by six and will add flights on two other routes. ANA will suspend six routes, and decrease flights at eight routes. ANA is optimizing its operational plan to take advantage of the Haneda airport expansion in 2009. The company plans to convert passenger flights to cargo to focus on its international postal cargo operations to China and other Asian countries.

¶16. (U) FedEx Showcases State-of-the-Art Warehouse  
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In a 6am visit to FedEx's Narita Airport facilities, EMIN observed the complex operations necessary to handle the more than 4,500 packages the company receives everyday. FedEx, the world's largest airline with 677 planes, also showcased its new 76,000 sqm. warehouse located in Odaiba. At a cost of \$18.5 million, it is the company's largest capital expenditure in the Asia Pacific. Representatives told EMIN that FedEx will close its Subic Bay facility and move the operations to Guangzhou in early 2008. They cited Subic Bay's short runways and Guangzhou's more central location as the reasons driving the move.

¶17. (U) Kansai Firms Favor ASEAN EPAs for Business Opportunities  
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Approximately 80 companies from Kobe and Osaka attended JETRO Kobe's recent FAZ seminar to hear about trade opportunities with ASEAN members, especially those with Japanese EPAs/FTAs. JETRO's Trade and Investment Advisor Kota Nagai told the audience that many countries were seeking to circumvent the "slow WTO process" with free trade agreements, and that such agreements presented firms with excellent business opportunities. Economic activity with ASEAN and Asia is becoming more important for Japan, he said.

He suggested that Osaka and Kobe firms with strong ties to mainland Asia could capitalize on cultural exchange and tourism business from EPAs. Nagai also cautioned that although large firms could quickly benefit from trade with EPA partners, SMEs would take several years due to the drag of high tariffs in EPA-excluded sectors.

¶18. (U) Western Japan: Unemployment Rate Falls But Contractors Increasing  
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According to the Ministry of Internal Affairs and Communications, unemployment in Western Japan mirrored the national downward trend. Following on the heels of the October decline, the unemployment rate in the Kansai fell by 0.6 points to 4.8 percent.

The median effective job offer rate throughout the Kansai region is 1.1, higher than the national median of 1.06 (with even better conditions in Osaka (1.28), and Shiga (1.31)).

Although the job offers are increasing, the growth appears to be coming from contractors and temporary employees rather than permanent positions. With 75 percent of job applicants seeking permanent positions and only 43 percent of companies offering them, there is a significant mismatch embedded in the job offer data. Despite the economic growth in the Kansai over the past two years, manufacturers continue to cut labor costs.

Nonetheless, one industry source said the current employment situation was still an improvement over what faced college grads a couple of years ago.

¶19. (U) Economic Recovery Widens Kyushu-Tokyo Income Gap  
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According to the Kyushu Economic Research Center (KERC), Japan's economic recovery has increased the income disparity between Kyushu and Tokyo residents.

Although the salary gap between the Greater Tokyo Area (Tokyo, Saitama, Chiba, and Kanagawa prefectures) and the nine-prefecture



Kyushu (including Okinawa)/Yamaguchi region somewhat narrowed from 2001-2003 when Japan's economy stagnated, the disparity began to grow again following the economy's recovery in 2003. For instance, while average total monthly wages (including overtime) for regular employees in Kyushu/Yamaguchi were 76.4% of those in Tokyo in 2003, they fell to 73.6% in 2005. A KERC official attributed the decrease to regional differences in the pace of the economic recovery. For now, it is unclear whether this regional income disparity issue will play a role in Kyushu/Yamaguchi during the upcoming unified local and Upper House elections in April and July, respectively.

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120. (SBU) Again, Fabricated Earthquake-Resistance Reports  
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Kyoto City officials announced January 25 that two hotels in the APA hotel group in Kyoto were built based on falsified structural-strength reports. According to MLIT and the city, Mitsuo Mizuochi, a Toyama City architect in charge of structural strength designs for the hotel chain, has admitted to falsifying the report for one of the hotels. MLIT is asking municipal governments in 15 prefectures including Toyama, Hiroshima, Hyogo, Osaka, and Ishikawa to look into the 168 other structures with which Mizuochi was involved. 116 of the buildings under investigation are in Toyama. A ConGen Osaka contact at Kyoto City denied the city had any involvement in the deception. According to media reports, last June Kobe City asked Mizuochi to submit additional information regarding APA hotels and condominiums in that city, a request Mizuochi ignored. It appears that Kobe took no further action, something that is likely to turn into an election issue very quickly. A MLIT Kinki Regional Bureau official said that the APA Group is well-known for undercutting the bids of other firms on public works projects.

121. (U) FDI Success For Central Japan: AMB Property To Open Distribution Center  
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San Francisco-based AMB Property Corp. announced January 30 that it will invest USD 100 million to build a six-story, 120,000 square meter (1.3 million square feet) logistics and distribution center in Kasugai City, Aichi Prefecture, by end of 2007. The distribution center will be AMB's largest facility in Japan and will be located in a suburb of Nagoya known as a hub of aerospace and machinery manufacturing.

AMB's decision to build in the region marks a success for the Greater Nagoya Initiative (GNI), the joint effort of Central Japan local and prefectural governments to attract FDI. AMB participated in the summer 2006 GNI Economic Symposium. Working through the GNI, Kasugai City assisted AMB with preliminary site negotiations, in particular helping smooth relations with neighbors concerned about an influx of cargo trucks.

122. (U) FCS-Sponsored Export Controls Conference a Big Success  
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Over 300 businesses signed-up to participate in a February 2 - 3 export control conference sponsored by FCS. Experts from Commerce, Treasury and State explained their respective control regimes and answered a myriad of questions. On the second day, businesses had an opportunity to have one-on-one consultations with these experts. This is the first export control conference to be held in Tokyo in three years.

SCHIEFFER